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RUEHGP/AMEMBASSY SINGAPORE 4286
RUMTBK/AMEMBASSY BANGKOK 5760
RUEHML/AMEMBASSY MANILA 6348
RUEHJA/AMEMBASSY JAKARTA 2019
RUEHMO/AMEMBASSY MOSCOW 6883
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C O N F I D E N T I A L BEIJING 23579

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E.O. 12356: DECL: OADR
TAGS: ECON, CH
SUBJECT: PREMIER ZHAO COMMENTS ON ECONOMIC REFORMS

REFS: A) BEIJING 17975 B) BEIJING 23108
- C) BEIJING 23141

1. CONFIDENTIAL--ENTIRE TEXT.

2. SUMMARY: IN RECENT MEETINGS WITH HIGH-LEVEL U.S. VISITORS, PREMIER ZHAO ZIYANG REVIEWED CHINA'S ECONOMIC REFORM PROGRAM. HE STRESSED THE BROAD ECONOMIC AND POLITICAL BASE OF THE REFORMS WHICH CONTRIBUTES TO STABILITY FOR THE FORESEEABLE FUTURE. CHINA'S LEADERSHIP RECOGNIZES THAT URBAN REFORMS ARE MORE COMPLICATED THAN THEIR RURAL COUNTERPARTS, BUT IS CONFIDENT THAT WITHIN FIVE YEARS THEY CAN BE CARRIED OUT SUCCESSFULLY. IN THIS PROCESS THE MARKET WILL PLAY AN INCREASINGLY IMPORTANT ROLE. ZHAO NOTED THAT PRICE REFORM IN PARTICULAR WILL BE DIFFICULT, AND IT APPEARS TO EMBASSY THAT THIS AREA OF THE REFORM WILL BE RELATIVELY LIMITED IN SCOPE. ZHAO OFFERED LITTLE IMPROVEMENT FOR FOREIGN INVESTORS IN THE NEAR TERM, BUT HINTED AT DEVELOPMENTS IN ENTERPRISE MANAGEMENT WHICH MIGHT PROVIDE OPPORTUNITIES FOR IMPROVED EFFICIENCY AS WELL AS INCREASED FOREIGN PARTICIPATION IN CHINA'S ECONOMIC PROGRAM. END SUMMARY.

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3. LAST MONTH CHINESE PREMIER ZHAO ZIYANG MET WITH TWO HIGH-LEVEL U.S. DELEGATIONS, ONE LED BY SENATOR JAKE GARN, AND ANOTHER BY FORMER SECRETARY OF STATE CYRUS VANCE. DURING EACH OF THOSE MEETINGS ZHAO REVIEWED CHINA'S ECONOMIC REFORM PROGRAM. FOLLOWING IS A SYNOPSIS OF THE MAIN POINTS COVERED. THIS REPORT HAS BEEN DELAYED BY THE PRESS OF BUSINESS HERE AND CONTINUED SHORTAGE OF STAFF.

4. THE ENVIRONMENT FOR CHANGE: ZHAO OPENED BOTH MEETINGS SAYING THAT CHINA HAS NOW ADOPTED TWO MAJOR POLICIES: THE OPENING TO THE OUTSIDE WORLD AND THE RE-INVIGORATION OF THE DOMESTIC ECONOMY THROUGH BASIC REFORMS. IN THE LAST FIVE YEARS, THESE REFORMS HAVE BEEN SUCCESSFUL BEYOND CHINA'S EXPECTATIONS. ZHAO SAID GROWTH IN 1983 WAS 11 PERCENT, IN 1985 12 PERCENT, AND IN 1985 IT COULD REACH 14 PERCENT. HIGH LEVELS HAD BEEN ACHIEVED IN AGRICULTURE, LIGHT INDUSTRY AND IN HEAVY INDUSTRY, AND MOST SIGNIFICANTLY THE STANDARD OF LIVING OF THE PEOPLE HAD CONCURRENTLY BEEN RAISED. EVEN CHANGES IN LEADERSHIP WOULD NOT THREATEN THESE POLICIES NOW. THEY ARE NOT THE DREAMS OR THE INVENTIONS OF A FEW LEADERS, BUT THE PRODUCT OF EXPERIENCE. IN BOTH MEETINGS ZHAO QUOTED CONFUCIUS TO DESCRIBE WHERE CHINA IS NOW: "WHEN A MAN IS THIRTY HE KNOWS HIMSELF, WHEN HE IS FORTY HE NO LONGER HAS DOUBTS" (SEE PARA 5 FOR COMMENT). CHINA IS NOW 35 YEARS OLD, AND HAS EXAMINED CAREFULLY THE LESSONS OF ITS PAST. IT WILL NOT MAKE THE SAME MISTAKES AGAIN. IN THE PAST CHINA'S POLICIES HAVE BEEN IN FLUX, BUT NOW THEY ARE STABLE, ROOTED IN THE SUPPORT OF THE PEOPLE. NEVERTHELESS, CHINA'S CURRENT LOW LEVEL OF DEVELOPMENT WILL REQUIRE SEVERAL DECADES TO CHANGE FUNDAMENTALLY.

5. COMMENT ON QUOTING FROM CONFUCIUS: SINCE THE 1970'S, CONFUCIUS HAS RETURNED TO SOME FAVOR AMONG CHINA'S EDUCATED, BUT IT IS STILL NOT A COMMON OCCURRENCE TO HEAR CONFUCIUS QUOTED, PARTICULARLY BY AN OFFICIAL OF ZHAO'S LEVEL. THIS PARTICULAR QUOTE COMES FROM THE WEI ZHENG, TRANSLATED SOMETIMES AS THE PRACTICE OF GOVERNMENT. IN IT CONFUCIUS DESCRIBED THE STAGES OF HIS OWN LIFE.
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COMMENTARIES HAVE EMPHASIZED THE NEED TO KNOW ONESELF IN ORDER TO BE ABLE TO DEAL EFFECTIVELY WITH THE CONFUSION OF OUTWARD EVENTS. END COMMENT.

6. THE ECONOMIC SYSTEM: CHINA HAS EXAMINED ITS PAST EXPERIENCE AND HAS CONCLUDED THAT NEITHER THE WESTERN NOR SOVIET MODELS ARE SUITED TO CHINESE CONDITIONS. CHINA IS THEREFORE LOOKING FOR ITS OWN MODEL. FOR ITS DEVELOPMENT, CHINA WILL RELY MAINLY ON ITS OWN EFFORTS BECAUSE IT HAS RICH RESOURCES AND A LARGE MARKET. NEVERTHELESS, THE FACT THAT CHINA CANNOT RELY COMPLETELY ON FOREIGN TRADE FOR DEVELOPMENT PURPOSES DOES NOT MEAN CHINA WILL REMAIN SECLUDED.

7. OWNERSHIP AND MANAGEMENT: IN GENERAL THE PUBLIC AND COLLECTIVE SECTORS ARE THE MOST IMPORTANT.

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HOWEVER, OTHERS WILL INCLUDE PRIVATE CHINESE OWNER-SHIP, JOINT VENTURES AND EVEN 100 PERCENT FOREIGN OWNERSHIP. THE PRIVATE SECTOR WILL COVER ONLY A CERTAIN AMOUNT AND WILL NOT AFFECT THE SOCIALIST NATURE OF THE ECONOMY. MANAGEMENT IS AN IMPORTANT PART OF THE REFORMS AND MAY BE HANDLED IN DIFFERENT WAYS. THE ASSETS OF GOVERNMENT FIRMS ARE OWNED BY THE STATE. HOWEVER, ALLOWANCE CAN BE MADE FOR THE SEPARATION OF OWNERSHIP AND MANAGEMENT. FIRMS WILL HAVE THE RIGHT TO OPERATE INDEPENDENTLY. IN THE FUTURE MANAGERS COULD BE APPOINTED BY THE STATE, OR THEY COULD BE CHOSEN AND EMPLOYED BY THE INDIVIDUAL ENTERPRISE. ANOTHER POSSIBILITY IS THAT FIRMS COULD BE LEASED TO INDIVIDUALS WHO HAVE THE COMPETENCE TO OPERATE THEM. AS LONG AS ENTERPRISES ABIDE BY THE LAWS AND REGULATIONS, AND PAY TAXES, THE STATE WILL NOT INTERFERE IN THEIR MANAGEMENT. THE ENTERPRISES WILL BE FREE TO ACT AS LEGAL PERSONS.

8. CENTRAL PLANNING: THE DEVELOPMENT OF THE REFORM PROGRAM WILL CERTAINLY REQUIRE CHANGES IN THE CENTRAL PLANNING SYSTEM. ALTHOUGH CHINA WILL NOT BECOME A MARKET ECONOMY IT WILL NOT BE AS CENTRALIZED AS BEFORE. IN THE FUTURE THE MANDATE OF CENTRAL PLANNING WILL BE REDUCED AND MORE RELIANCE WILL BE PLACED ON GUIDANCE PLANNING. THE SIZE OF THE CHINESE BUREAUCRACY WILL BE REDUCED, AND INEVITABLY PRICE AND MARKET WILL PLAY INCREASINGLY IMPORTANT ROLES IN THE ECONOMY. THERE IS THEREFORE A THREE-TIER REFORM UNDER WAY: IN THE PLANNING SYSTEM, IN PRICES, AND IN THE OPERATION OF ENTERPRISES.

9. PRICE REFORM AND INFLATION: PRICE REFORM WILL BE PARTICULARLY DIFFICULT, BUT CHINA INTENDS TO HAVE RATIONAL PRICES AND TO ALLOW MARKET FORCES TO DETERMINE MANY OF THOSE PRICES. DECENTRALIZATION WILL REQUIRE MORE RELIANCE ON THE PRICE SYSTEM. CARE WILL BE TAKEN TO AVOID INFLATION AND CHINA'S LEADERS ARE CERTAIN THE RUNAWAY INFLATION OF THE KUOMINTANG ERA CAN BE PREVENTED. NOT ALL PRICES WILL GO UP, AND SOME WILL GO UP MORE THAN OTHERS. ONE WAY TO CONTROL EXCESSIVE PRICE RISES IS TO IMPROVE EFFICIENCY. ANOTHER WAY TO EASE THE ADJUSTMENT DIFFICULTIES FOR ENTERPRISES IS TO LOWER TAXES SELECTIVELY. ZHAO POINTED TO THE GOVERNMENT'S ACTION IN RAISING COTTON PRICES LAST YEAR AS ONE WHICH SUCCESSFULLY AVOIDED INFLATION. (COMMENT: IT MAY HAVE AVOIDED INFLATION, BUT IT CREATED SUBSTANTIAL SURPLUSES OF COTTON. END COMMENT)

10. URBAN REFORMS: IN THE LAST FIVE YEARS THE
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RURAL REFORMS HAVE BEEN TREMENDOUSLY SUCCESSFUL. REFORMS IN THE URBAN AREAS HAVE BEEN LIMITED TO EXPERIMENTS, AND STANDARDS OF LIVING HAVE NOT RISEN AS RAPIDLY AS IN RURAL AREAS. IT IS MORE COMPLICATED TO INTRODUCE REFORM INTO URBAN AREAS. HOWEVER, THE SUCCESS OF THE RURAL REFORMS AND THE CORRESPONDING ECONOMIC ADVANCES HAVE CREATED FAVORABLE CONDITIONS FOR MORE SWEEPING REFORMS IN THE CITIES. DURING THE NEXT FIVE YEARS CHINA WILL CONCENTRATE ON THIS FIELD. CHINA IS CONFIDENT THAT

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THERE WILL BE NO MAJOR PROBLEMS AND THAT RISKS CAN BE AVOIDED. IN SEVERAL YEARS THE URBAN REFORMS WILL BE JUST AS SUCCESSFUL AS THE RURAL REFORMS, PROVIDING FOR INCREASES IN PRODUCTION AND A VITALIZATION OF THE ECONOMY. THIS WILL IN TURN CREATE BETTER CONDITIONS FOR OUTSIDE INVESTMENT AND TRADE.

11. FOREIGN INVESTMENT: CHINA IS "DEVELOPING ANSWERS" TO THE MYRIAD OF QUESTIONS SURROUNDING FOREIGN INVESTMENT, AND HAS NOT COMPLETED ITS PLANS. THE LEGAL SYSTEM IS INADEQUATE AND THE LAWS ARE NOT DETAILED ENOUGH. IN THE ABSENCE OF LAWS GOVERNING CERTAIN TYPES OF OPERATIONS, THE INDIVIDUAL CONTRACTS SIGNED BY FIRMS WILL HAVE THE BINDING FORCE OF LAW. CONCERNING THE REPATRIATION OF PROFITS THE STATE MUST CONSIDER FIRST ITS OWN ABILITY TO PAY. IN SOME CASES REMITTANCES WILL BE BASED ON THE PROPORTION OF DOMESTIC SALES TO EXPORT SALES, BUT DETAILS MUST BE WORKED OUT IN THE INDIVIDUAL CONTRACTS. OVER TIME THESE QUESTIONS WILL BE WORKED OUT, AND THE OPENING AND INVIGORATING OF CHINA'S ECONOMY WILL PROVIDE OPPORTUNITIES TO BRING SINO-U.S. TECHNOLOGICAL COOPERATION TO NEW LEVELS.

12. COMMENT: ZHAO'S BRIEFINGS ON THESE ISSUES WERE CONCISE AND WELL ORDERED. MOST OF THE INFORMATION IS NOT NEW, AS IT IS OFTEN REFLECTED IN THE PRESS AND IN CONVERSATIONS WITH OTHER OFFICIALS. IN FACT, IN MANY INSTANCES THE BRIEFINGS GIVEN BY OTHER PRC OFFICIALS COINCIDE VIRTUALLY WORD FOR WORD. IT IS AN OFFICIAL LINE WHICH IS CAREFULLY DISSEMINATED AND REPEATED RIGHT DOWN INTO THE LOWEST LEVELS OF THE BUREAUCRACY. NEVERTHELESS, SEVERAL POINTS ARE NOTEWORTHY:

13. THERE IS INCREASING EMPHASIS ON CHINA'S MARKET. MARKET MECHANISMS WILL BE USED TO SUPPLEMENT THE PLAN AND TO REPLACE IT IN SOME AREAS. ZHAO'S STATEMENT SPECIFICALLY NOTES THAT CHINA WILL NOT ONLY RELY ON ITSELF FOR PRODUCTIVE PURPOSES, BUT WILL PROVIDE THE CONSUMPTION END OF THE EQUATION AS WELL--I.E., IN CONTRAST TO OTHER EXPORT-ORIENTED ASIAN ECONOMIES. THE SOVIET MODEL IGNORES THE MARKET, AND IN OTHER CONVERSATIONS WITH ECONOMISTS IN THE CHINESE ACADEMY OF SOCIAL SCIENCES (CASS), THE CHINESE HAVE CRITICIZED THE USSR FOR REFUSING TO TAKE THIS IMPORTANT MECHANISM INTO CONSIDERATION.

14. THE CHINESE WILL CONTINUE TO BE JEALOUS OF THEIR MARKET, HOWEVER, AND WILL PROTECT IT. ZHAO TOLD VANCE THAT SALES BY FOREIGN INVESTORS IN CHINA TO THE CHINESE MARKET WILL HAVE TO BE BALANCED BY THEIR EXPORTS FROM CHINA. VICE PREMIER YAO YILIN, IN HIS MEETING WITH CODEL GARN, MADE IT CLEAR THAT CHINA WILL CONTINUE TO RESTRICT ACCESS TO ITS DEVELOPING MARKET. HE DID NOTE, HOWEVER, THAT CHINA WAS CONSIDERING THE POSSIBILITY OF "ALLOTING" (HUAFEN) DIFFERENT PORTIONS OF THE DOMESTIC MARKET TO FOREIGN SUPPLIERS AND THE U.S. MIGHT TAKE ADVANTAGE OF SOME OF THESE ALLOTMENTS.

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15. THE CHINESE LEADERSHIP IS STILL VERY CONCERNED OVER INFLATION. THEY SEE THE NEED FOR PRICE REFORM, BUT ARE AFRAID OF THE SHORT-TERM INFLATIONARY CONSEQUENCES. THE BUREAUCRACY WILL THEREFORE REMAIN FIRMLY IMPLANTED AS A MEDIATOR BETWEEN THE MARKET AND PRICES. COMMENTS BY ECONOMIC OFFICIALS IN AN EMBASSY-SPONSORED SEMINAR IN SEPTEMBER (REF A) SUGGESTED PRICE REFORM LARGELY MEANS PRICE ADJUSTMENT, NOT FREE DETERMINATION BY MARKET FORCES. OFFICIALS HAVE BEEN WATCHING VERY CAREFULLY THE PUBLIC REACTION TO RUMORED PRICE INCREASES, AND ARE NOT LIKELY TO RELINQUISH SUBSTANTIAL CONTROL OVER PRICES OR THE SUPPLY OF IMPORTANT RAW MATERIALS AND FOODSTUFFS (REFS B AND C).

16. FINALLY, ZHAO WAS CAREFUL TO POINT OUT THAT THE GROWTH OF THE PRIVATE SECTOR WILL BE LIMITED, AND WILL NOT AFFECT THE SOCIALIST NATURE OF THE ECONOMY. NEVERTHELESS, HIS COMMENTS ABOUT MANAGEMENT, PARTICULARLY THE POSSIBILITY OF LEASING OUT ENTERPRISES MAY EVENTUALLY PROVIDE SIGNIFICANT NEW GROUND FOR INCREASED INITIATIVE. PRESS REPORTS INDICATE THIS IS ALREADY BEING EXPERIMENTED WITH, AND WE WONDER IF IT MIGHT EVENTUALLY INCLUDE LEASING TO FOREIGN MANAGEMENT. THERE IS AT LEAST ONE CASE IN WUHAN WHERE A FOREIGNER IS MANAGING A STATE FACTORY WHICH HONG KONG ECON SECTION CHIEF VISITED RECENTLY. END COMMENT. HUMMEL
END OF MESSAGE

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